Portfolio Manager Perspectives
Jeff Benjamin

New covered-call fund from M.D. Sass hedges stock and bond markets

Offering uses strategy modeled after existing SMA; alternative to long-short equity investing

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By **Jeff Benjamin**

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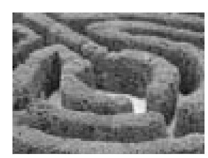

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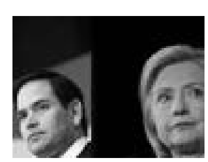

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Veteran investor Martin Sass is homing in on what he sees as a keen opportunity in the retail investor arena.

The chief executive of the $8.5 billion asset management firm M.D. Sass Investors Services Inc. thinks that the time has come to start hedging the stock and bond markets, which is the primary pitch behind the new M.D. Sass Equity Income Plus Fund (MDEIX).

The mutual fund, which was launched June 28 and is only the second fund offered by the company, is modeled after an existing covered-call separately managed account.

“In today's environment, this kind of fund is generating cash flow well in excess of what you're getting from any quality investment,” Mr. Sass said.

The basic strategy involves leveraging the firm's equity investing expertise to invest in high-quality but undervalued dividend-paying mid- to large-cap stocks.

The dividend income is expected to generate about 2.5%, but is enhanced through the sale of out-of-the money call options, which can limit the upside performance but can also provide a steady and predictable income stream.

“Typically, we may buy a stock and sell call options that are 10% higher that can be exercised,” Mr. Sass said. “That gives us the additional income over and above the income

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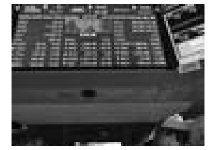

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The income from call options will vary depending on the market's appetite and belief that stocks are poised to rise, but Mr. Sass said that the current option premium adds up to an annualized rate of 8.8% for a total fund income rate of 11.3%.

That income is trimmed by between 1% and 2%, however, through the sale of index put options that are designed to provide the portfolio with some downside protection.

"These puts increase in value when the market declines, and that's why they are a hedge against sharp market drops," he said.

The puts, which are purchased on 73% of the portfolio, are 12% out of the money, meaning that the protection kicks in once those underlying investments decline by more than 12%.

"In a very flat market, this strategy will produce 10% income even if the market does nothing," Mr. Sass said. "On the upside, we would tend to participate in a moderately rising market and underperform in a sharply rising market because the stocks will get called away once they hit the exercise price."

The covered call strategy isn't necessarily new

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to the fund industry, but Mr. Sass is promoting it as an alternative to hedging strategies employed through long-short equity investing.

The M.D. Sass SMA using the same strategy has produced a compound total return of 11.3% from June 2009 through Friday, compared with a 6.5% compound total return for the hedge fund benchmark HFRI Index.

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